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RUEHQT/AMEMBASSY QUITO 2039
RUEHSG/AMEMBASSY SANTIAGO 3485
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SUBJECT: HOW VENEZUELAN'S OBTAIN FOREIGN CURRENCY IN THE
PARALLEL MARKET

REF: A. CARACAS 03134
[1](#)B. CARACAS 02826
[1](#)C. CARACAS 03601
[1](#)D. CARACAS 00512
[1](#)E. CARACAS 00659
[1](#)F. CARACAS 03782

SUMMARY

[1](#)1. (SBU) Average Venezuelans have found a variety of ways, beyond the official Foreign Exchange Administration Commission (CADIVI), to convert Bolivars to foreign currency. Options include trading Bolivar-denominated bonds for foreign currency-denominated bonds, purchasing dollar-denominated BRV and Argentine bonds, and buying American depository shares (e.g. shares of local telecommunications company CANTV that are tradable for U.S. dollars). Most of these "parallel market" transactions are legal, or at least, arguably legal. Financial contacts estimate the parallel market transactions (for Bolivars and for foreign currency) to be between USD 15-25 million daily. Most financial sector contacts believe that the black market is much smaller. We expect the parallel market to remain strong given the uncertain political environment.

CADIVI: THE OFFICIAL MARKET

[1](#)2. (SBU) In the aftermath of the general strike which shut down petroleum production from December 2002 through January 2003, the BRV established exchange controls and required that the Foreign Exchange Administration Commission (CADIVI) administer all foreign exchange transactions (reftel A). However, at the time, the BRV did not establish penalties for failure to comply with the law. In September 2005, the Foreign Exchange Crime Law (Official Gazette No. 38,272) imposed penalties and criminal sanctions for illegal exchange transactions (reftel B). As of May 2006, the official exchange rates are 2,144 Bolivars/USD for purchase operations and 2,150 Bolivars/USD for sale operations. (Note: We estimate that the official exchange rate overvalues the Bolivar by approximately 20 percent. End Note.)

¶3. (U) CADIVI, known for its strict application requirements, requires a significant amount of information be provided by applicants. This includes commercial registry, shareholders assembly meeting report, proof of payment to social security, tax registration number, administrators and legal representatives, proof of payment for municipal taxes, and proof of payments for value added taxes and federal income taxes. CADIVI approves foreign exchange requests for specific purposes such as imports, study and travel abroad, family remittances, foreign debt payments, insurance, health care, airline services, and royalties (reftel B). In March 2006, CADIVI authorized an average of USD 76 million daily in foreign exchange requests, which financial sector contacts estimate satisfies approximately 80 percent of the demand for foreign currency, primarily U.S. dollars. The parallel market serves those individuals and companies that may not meet CADIVI's requirements (e.g., tax solvency), those requesting foreign currency for purposes not authorized by CADIVI, those who wish to hide otherwise permissible transactions from the BRV, and those who wish to purchase cheaper Bolivars at the parallel market rate or CANTV rate, rather than the overvalued official rate.

THE PARALLEL MARKET

¶4. (U) Parallel market transactions fluctuate between USD 15-25 million a day, according to financial sector contacts. Contacts say that swap transactions (commonly known as "la permuta") are the most popular. To complete the "la permuta" transaction, a person wanting U.S. dollars, first buys BRV

domestic bonds through a broker and then, swaps the BRV domestic bonds for dollar-denominated government bonds of equivalent value. The dollar-denominated government bonds are usually BRV bonds periodically issued, or highly tradable bonds from another country. The person then sells the government dollar-denominated bonds to obtain U.S. dollars. This series of transactions can also work in reverse to purchase Bolivars.

¶5. (U) A financial broker contact estimates that approximately 70 domestic brokers (those registered at the Caracas Stock Exchange and unregistered), conduct "la permuta" transactions, working with an offshore company, for their clients (individuals and corporations). The Foreign Exchange Crime Law (passed in September 2005) includes a loophole for operations in securities, originally advocated by the BRV's Finance Ministry to allow it to continue issuing dollar denominated bonds purchasable locally in Bolivars, which many Venezuelans have interpreted to allow these transactions. However, more conservative financial institutions consider the transactions legally questionable.

¶6. (SBU) Another financial contact offered a variation on the "la permuta" transactions, whereby the broker purchases a BRV bond in Bolivars for the client and then sells the same bond overseas to his foreign affiliate. The foreign affiliate pays for the bonds in U.S. dollars or other foreign currency. The process generally takes 3 days. Our contact preferred these transactions to "la permutas" because the transactions, he claimed, had been legally certified by an international accounting firm.

¶7. (SBU) Venezuelans wishing to purchase U.S. dollar can also invest in American depository shares (ADS), traded on the Caracas Stock Exchange. Contacts say that about USD 1 million is traded through ADS each day. Local telecommunication company CANTV is the most well-known, but other options exist, including the paper products producer Mampa, the local steel company SIVENSA, and the state electric company Electricidad de Caracas. Brokerage houses buy and sell ADS and package seven ADS to sell for U.S. dollars as an American depository receipt (ADR) on the NYSE. (Note: CANTV selected Banco Venezolano de Credito as the sole financial intermediary to trade CANTV ADS, packaged as ADRs,

with New York. The Bank of New York reportedly handles the CANTV transactions in the United States. End Note.)

¶8. (SBU) Brokers calculate the implicit rate for the CANTV dollar and the "la permuta" dollar based on each day's trading action. For April 20, 2006, the CANTV exchange rate was 2,550 Bolivars per U.S. dollar and the "la permuta" rate was 2,580 Bolivars per U.S. dollar. A financial broker contact warned that the time delay to complete the CANTV transaction creates some uncertainty about the implicit exchange rate for the purchaser. Another contact estimated that the CANTV transactions take approximately 3 weeks. These transactions also work in reverse; those interested in trading U.S. dollars for Bolivars can go to Bank of New York to purchase ADRs to trade back to ADS for Bolivars. One financial sector contact recommended this option to clients wishing to bring money into Venezuela while avoiding the uncertainty of capital gains taxes. According to this contact, clients pay a 1 percent tax on the transaction earnings and have no further tax liability.

¶9. (SBU) To change Bolivars to U.S. dollars, Venezuelans can also purchase dollar-denominated BRV or Argentine bonds (reftel C and D), purchasable locally in Bolivars and have them resold abroad. In the case of BRV bonds, brokerage houses place orders for the desired number of bonds with the Finance Ministry, which allocates the number of bonds to buyers. According to a financial broker contact, the Finance Ministry sells the bonds at the official rate, but the market adds a premium to the bond price because the bond is highly demanded by the market. Depending on market conditions, the range for the implicit exchange rate for Finance Ministry bonds could be between 2,300-2,500 Bolivars per U.S. dollar versus the official exchange rate of 2,150. In the case of

the Argentine bonds, the Finance Ministry allocates Argentine bonds to financial institutions, who then resell them (reftel E and F). A financial broker described these transactions as slightly inconvenient for potential investors because the availability of these bonds is sporadic and the transactions are one-way (exclusively Bolivars to U.S. dollars). Also, the Finance Ministry may not allocate to a potential investor the entire number of bonds the investor requests to purchase.

¶10. (SBU) Other transactions involve trading foreign currency with unauthorized dealers (black market) or receiving payment for domestically provided goods and services in accounts abroad (typically, in the United States). One financial contact noted that the BRV pays some domestic service providers directly to their accounts abroad.

COMMENT

¶11. (SBU) Venezuelan private sector demand for foreign currency through the parallel market continues to be strong as Venezuelans try to hedge their bets in advance of an expected devaluation in 2007 and the uncertain political environment. The BRV appears tolerant of the parallel market and will likely remain so, as long as the parallel market offers the BRV some convenience. For example, the BRV has benefited from its participation in the parallel market with the selling of BRV bonds and Argentine bonds. To date, the BRV has not issued regulations for the New Foreign Exchange Crime Law, which allows legal uncertainty about some transactions to continue. This legal uncertainty allows the BRV flexibility to determine potential oversight options.

BROWNFIELD